**SEPTEMBER 2008**

# IFRS CONSULTATION

December 2011 Financial Information
Prepared in accordance with
Canadian Generally Accepted
Accounting Principles

**Prepared by OEB staff For Discussion Purposes Only**

# Preface to example financial statements of Simulated Distribution Utility Inc.

***(Prepared in accordance with issued Canadian GAAP as at May 15, 2008)***

## 1. About this publication

These example general-purpose financial statements have been developed by the Ontario Energy Board ("OEB") staff. The presentation, illustrations, assumptions and accounting policies presented herein have been selected by OEB staff solely for the purpose set out below. The OEB currently does not prescribe how the regulatory accounts contained in the Uniform System of Accounts ("USoA") roll up for purposes of general-purpose financial reporting. Presentation in general-purpose financial statements is left at the discretion of each utility. The OEB published USoA has been used as the starting point for the rollup of these example financial statements.

Simulated Distribution Utility Inc. is a hypothetical rate-regulated distribution utility conducting its operations in the province of Ontario, Canada, and does not represent any existing regulated utility. While language chosen in these example financial statements is that of the electricity distribution sector, the electricity transmission or the gas distribution sectors could also have been chosen to create the illustration. The authors believe the concepts illustrated by these statements can be applied to general-purpose financial statements for all three of these sectors. Also, the concepts illustrated are assumed to be applicable in the electricity generation sector as well. Additional industry specific requirements in all these other sectors will need to be addressed by the sector participants.

During the development and preparation of these example financial statements, OEB staff consulted with KPMG on matters related to Canadian Generally Accepted Accounting Principles.

## 2. Purpose of these example financial statements

The purpose of these financial statements is to illustrate an example of general-purpose financial statements of a distribution utility prepared in accordance with Canadian Generally Accepted Accounting Principles ("Canadian GAAP"). The financial statements illustrate one possible reporting format for Canadian GAAP general-purpose financial statements, based on Simulated Distribution Utility Inc, a hypothetical entity.

OEB staff has developed these example financial statements to assist it in leading the consultation process that is aimed at establishing and considering the implications of the transition to IFRS on regulatory accounting instruments, (e.g., gas and electricity USoA) and processes related to them. While rate-regulated utilities may find certain elements of these example general-purpose financial statements useful, these financial statements are not intended to identify or address every possible reporting scenario or circumstance that may arise nor are they considered to be an OEB endorsed template. As a result, they should be used only for the limited purpose that is mentioned above.

In addition, separate accompanying example financial statements for 2011 have been prepared in accordance with International Financial Reporting Standards, with comparatives figures for 2010. Together these financial statements show potential accounting differences or impacts on conversion from Canadian GAAP to IFRS.

## 3. Canadian GAAP Standards used in these example financial statements

Canadian GAAP pronouncements are subject to ongoing revision by the Canadian Accounting Standards Board. As a result, measurement and disclosures in general-purpose financial statements may change materially in response to subsequent changes or revisions to the pronouncements.

Except as detailed below, these example general-purpose financial statements have been prepared based on Canadian GAAP pronouncements that were issued as at May 15, 2008.

- Financial instruments – disclosure

  CICA 3862, issued in December 2006, places increased emphasis on disclosures regarding the risks associated with both recognized and unrecognized financial instruments and how these risks are managed. It is effective from fiscal years beginning on or after October 1, 2007. Due to the above limited purpose for which these example financial statements have been developed, detailed financial instrument disclosures have not been considered necessary.

- Capital disclosures

  CICA 1535, issued in December 2006, establishes guidelines for the disclosure of information regarding an entity's capital and how it is managed. It is effective from fiscal years beginning on or after October 1, 2007, and has enhanced disclosure with respect to the objectives, policies and processes for managing the capital. Due to the above limited purpose for which these example financial statements have been developed, detailed capital disclosures have not been considered necessary.

- Intangible assets

  CICA 3064, *Goodwill and Intangible assets*, establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. It is effective from fiscal years beginning on or after October 1, 2008. These example general-purpose financial statements have not been adjusted to reflect the new requirements under CICA 3064.

In practice, entities will have to comply with the requirements of the above CICA Handbook Sections in preparing their Canadian GAAP financial statements for each of the years that are covered by the new financial reporting requirements.

**SEPTEMBER 2008**

Example Financial Statements of

# SIMULATED DISTRIBUTION UTILITY INC.

Year ended December 31, 2011

*(Prepared in accordance with issued Canadian GAAP as at May 15, 2008)*

**Prepared by OEB staff For Discussion Purposes Only**

# SIMULATED DISTRIBUTION UTILITY INC.

Balance Sheet
(In thousands of dollars)

December 31, 2011, with comparative figures for 2010

| | 2011 | 2010 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 35,000 | $ 33,000 |
| Bank balances held for customer deposits | 22,000 | 22,000 |
| Available-for-sale investments | 22,000 | 21,000 |
| Accounts receivable | 45,000 | 48,000 |
| Unbilled revenue | 49,000 | 41,000 |
| Amounts due from related parties, without interest (note 12) | - | 1,000 |
| Inventories | 7,000 | 5,000 |
| Prepaid expenses and deposits | 1,000 | 1,000 |
| | 181,000 | 172,000 |
| Capital assets (note 3) | 419,000 | 404,000 |
| Other assets: | | |
| Regulatory assets (note 4) | 13,126 | 24,251 |
| Goodwill | 2,000 | 2,000 |
| | 15,126 | 26,251 |
| | $ 615,126 | $ 602,251 |
| **Liabilities and Shareholder's Equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 70,000 | $ 77,000 |
| Payments in lieu of corporate income taxes payable | 3,000 | 4,000 |
| Advance payments | 2,000 | 2,000 |
| Amounts due to related parties, without interest (note 12) | 1,000 | 2,000 |
| Customer deposits | 22,000 | 22,000 |
| | 98,000 | 107,000 |
| Regulatory liabilities (note 4) | 24,000 | 10,000 |
| Long-term liabilities: | | |
| Bonds payable (note 5) | 289,000 | 288,000 |
| Asset retirement obligation | 5,000 | 4,500 |
| Employee retirement and post-retirement benefits (note 8) | 3,000 | 3,000 |
| Future income taxes (note 2) | 6,126 | 7,251 |
| | 303,126 | 302,751 |
| Shareholder's equity: | | |
| Capital stock (note 6) | 156,000 | 156,000 |
| Accumulated other comprehensive income | 2,000 | 1,000 |
| Retained earnings | 32,000 | 25,500 |
| | 190,000 | 182,500 |
| Contingencies (note 9) | | |
| Commitments (note 10) | | |
| | $ 615,126 | $ 602,251 |

See accompanying notes to financial statements.

# SIMULATED DISTRIBUTION UTILITY INC.

Statement of Income and Comprehensive Income
(In thousands of dollars)

Year ended December 31, 2011, with comparative figures for 2010

| | 2011 | 2010 |
|---|---|---|
| Revenue: | | |
| Energy sales | $ 570,000 | $ 557,000 |
| Distribution | 108,000 | 104,000 |
| Recovery of regulatory assets | 6,000 | 7,000 |
| | 684,000 | 668,000 |
| Other income | 5,000 | 3,000 |
| Operating expenses: | | |
| Energy purchases | 570,000 | 557,000 |
| Operations, maintenance and administration | 41,000 | 37,000 |
| Amortization of capital assets | 32,000 | 30,000 |
| Amortization of regulatory assets | 6,000 | 7,000 |
| | 649,000 | 631,000 |
| Operating income | 40,000 | 40,000 |
| Non-operating revenue (expense): | | |
| Interest income | 3,000 | 3,000 |
| Interest expense | (20,000) | (19,000) |
| | (17,000) | (16,000) |
| Income before payments in lieu of corporate income taxes | 23,000 | 24,000 |
| Payments in lieu of corporate income taxes (note 2) | (9,000) | (11,000) |
| Net income | $ 14,000 | $ 13,000 |
| Unrealized gain on available-for-sale investments | 2,000 | 1,000 |
| Reclassification adjustment for gains included in net income, net of taxes of 300 | (1,000) | (2,000) |
| Comprehensive income | $ 15,000 | $ 12,000 |

See accompanying notes to financial statements.

# SIMULATED DISTRIBUTION UTILITY INC.

Statement of Retained Earnings
(In thousands of dollars)

Year ended December 31, 2011, with comparative figures for 2010

| | 2011 | 2010 |
|---|---|---|
| Retained earnings, beginning of year | $ 25,500 | $ 21,500 |
| Net income | 14,000 | 13,000 |
| Dividends paid (note 6(b)) | (7,500) | (9,000) |
| Retained earnings, end of year | $ 32,000 | $ 25,500 |

See accompanying notes to financial statements.

Statement of other comprehensive income
Year ended December 31, 2011, with comparative figures for 2010

| | 2011 | 2010 |
|---|---|---|
| Balance, beginning of year | $ 1,000 | $ 2,000 |
| Unrealized gain on available-for-sale financial assets | 2,000 | 1,000 |
| Realized gain on available-for-sale financial assets | (1,000) | (2,000) |
| Balance, end of year | $ 2,000 | $ 1,000 |

See accompanying notes to financial statements.

# SIMULATED DISTRIBUTION UTILITY INC.

Statement of Cash Flows
(In thousands of dollars)

Year ended December 31, 2011, with comparative figures for 2010

| | 2011 | 2010 |
|---|---|---|
| Cash provided by (used in): | | |
| Operating activities: | | |
| Net income | $ 14,000 | $ 13,000 |
| Items not affecting cash: | | |
| Amortization of debt issue costs | 1,000 | 1,000 |
| Amortization of capital assets | 32,000 | 30,000 |
| Amortization of regulatory assets | 6,000 | 7,000 |
| Gain (loss) on the disposal of capital assets | (1,000) | 2,000 |
| Asset retirement obligation | 500 | 1,000 |
| Employee retirement and post-retirement benefits | - | 1,000 |
| | 52,500 | 55,000 |
| Change in non-cash operating working capital (note 7) | (15,000) | (34,000) |
| | 37,500 | 21,000 |
| Financing activities: | | |
| Dividends paid | (7,500) | (9,000) |
| Investing activities: | | |
| Additions to capital assets | (48,000) | (37,500) |
| Proceeds on disposal of capital assets | 2,000 | 4,000 |
| Decrease in regulatory assets/liabilities (excludes regulatory asset for future taxes) | 18,000 | (2,000) |
| | (28,000) | (35,500) |
| Increase (decrease) in cash and cash equivalents | 2,000 | (23,500) |
| Cash and cash equivalents, beginning of year | 33,000 | 56,500 |
| Cash and cash equivalents, end of year | $ 35,000 | $ 33,000 |
| Supplemental cash flow information: | | |
| Interest received | $ 3,000 | $ 3,000 |
| Interest paid | 17,800 | 18,000 |
| Payments made in lieu of corporate income taxes paid | 10,000 | 13,000 |

See accompanying notes to financial statements.

Simulated Distribution Utility Inc. is the electric distribution utility for residents of the City.

**1. Significant accounting policies:**

(a) Basis of accounting:

These financial statements have been prepared by management in accordance with generally accepted accounting principles ("GAAP").

(b) Rate setting:

The Corporation is regulated by the Ontario Energy Board ("OEB") under authority of the Ontario Energy Board Act, 1998. The OEB is charged with the responsibility of approving or setting rates for the transmission and distribution of electricity and the responsibility for ensuring that distribution companies fulfill obligations to connect and service customers.

The OEB has the general power to include or exclude costs, revenue, losses or gains in the rates of a specific period, resulting in the change in the timing of accounting recognition from that which would have applied in an unregulated company. Specifically, the following accounting treatments have been applied:

(i) An amount to represent the cost of funds used during construction and development has been applied based on the value of construction in progress.

(ii) The Corporation records future income tax assets or liabilities arising from its business activities. However, to the extent that it is expected that the recovery/realization or payment of these amounts will be included in future distribution rates, a regulatory liability or asset is also recognized on these future income tax assets or liabilities.

**1. Significant accounting policies (continued):**

(iii) The Corporation has deferred certain retail settlement variances in accordance with Article 490 of the OEB's Accounting Procedures Handbook.

(iv) The Corporation has deferred the recognition of the employer's share of contributions to the Ontario Municipal Employees Retirement System ("OMERS") from January 1, 2005 to April 30, 2006.

(c) Cash and cash equivalents:

Cash and cash equivalents are defined as cash and bank term deposits or equivalent financial instruments with original maturities upon issue of less than 90 days.

(d) Revenue recognition:

Distribution revenue attributable to the delivery of electricity is based upon OEB-approved distribution tariff rates and is recognized as electricity is delivered to customers, which includes an estimate of unbilled revenue, which represents electricity consumed by customers since the date of each customer's last meter reading. Actual electricity usage could differ from estimates.

Other revenue is recognized as services are rendered or contract milestones are achieved.

(e) Measurement uncertainty:

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Accounts receivable is reported based on amounts expected to be recovered less an appropriate allowance for unrecoverable amounts based on prior experience. Unbilled revenue and regulatory assets are reported based on amounts expected to be recovered. Inventory is recorded net of a provision for obsolescence. Amounts recorded for amortization of capital assets are based on estimates of useful life.

**1. Significant accounting policies (continued):**

Due to the inherent uncertainty involved in making such estimates, actual results could differ from estimates recorded in preparing these financial statements, including changes as a result of future decisions made by the OEB or the Minister of Energy.

(f) Inventories:

Inventories, which consist of parts and supplies acquired for internal construction or consumption, are valued at the lower of cost and net realizable value. Cost is determined on the first-in, first out basis.

(g) Capital assets:

Capital assets are recorded at cost and include contracted services, materials, labour, engineering costs, overheads and an allowance for the cost of funds used during construction when applied. Certain assets may be acquired or constructed with financial assistance in the form of contributions from developers or customers. The OEB requires that such contributions, whether in cash or in kind, be offset against the related asset cost. Contributions in-kind are valued at their fair market value at the date of their contribution.

When capital assets that are subject to the group depreciation method are retired or otherwise disposed of, their original cost is charged against accumulated amortization and any salvage value recovered is credited against accumulated amortization. When capital assets that are not subject to the group depreciation are retired or otherwise disposed of, their original cost and accumulated amortization are removed from the accounts and the related gain or loss is included in the operating results for the related fiscal period.

In the event that facts and circumstances indicate that capital assets may be impaired, an evaluation of recoverability is performed. For purposes of such an evaluation, the estimated future undiscounted cash flows associated with the asset are compared to the carrying amount of the asset to determine if a write-down is required. If so, the impairment loss is measured as the amount by which the carrying amount of the asset exceeds its fair value.

(In thousands of dollars)

**1. Significant accounting policies (continued):**

Amortization of capital asset values is charged to operations on a straight-line basis over their estimated service lives as follows:

| | Estimated service life |
|---|---|
| Buildings | 50 years |
| Distribution substation equipment | 30 years |
| Other distribution system equipment | 25 years |
| Equipment and furniture | 10 years |
| Computer software | 2 years |

Distribution substation equipment and other distribution system equipment are depreciated using the group depreciation method.

Amortization is recorded at one-half the usual annual rate for assets placed into service in the current fiscal period.

Construction in progress comprises capital assets under construction, assets not yet placed into service and pre-construction activities related to specific projects expected to be constructed.

An allowance for the cost of funds used during the construction period has been applied. The prescribed interest rate used during the period equalled the Scotia Capital Inc. mid-term all corporate average weighted yield, as published on the Bank of Canada's website, updated quarterly. From May 1, 2010 to June 30, 2010, the rate used was 4.68%. From July 1, 2010 to September 30, 2010, the rate used was 5.05%. From October 1, 2010 to December 31, 2010, the rate used was 4.72%. From January through June 2011, the rate used was 4.72%. From July 1, 2011 to December 31, 2011, the rate used was 5.18%.

(h) Deferred debt issue costs:

Deferred debt issue costs represent the cost of the issuance of the bonds. The bonds are accreted back to their face value using the effective interest rate method over the remaining period to maturity.

**1. Significant accounting policies (continued):**

(i) Consumer deposits:

Customers may be required to post security to obtain electricity or other services. Where the security posted is in the form of cash or cash equivalents, these amounts are recorded in the accounts as deposits and prudentials, which are reported separately from the Corporation's own cash and cash equivalents. Interest rates paid on customer deposits are based on a variable rate of prime less 2.0%, updated quarterly.

(j) Asset retirement obligations

The fair value of asset retirement obligations (AROs) associated with the retirement of long-lived assets are recognized as long-term liabilities in the period when they can be reasonably determined. The fair value approximates the cost a third party would charge in performing the tasks necessary to retire such assets and is recognized at the present value of expected future cash flows. AROs are added to the carrying value of the associated asset and depreciated over the asset's useful life. The corresponding liability is accreted over time through charges to earnings and is reduced by actual costs of decommissioning and reclamation. The Company's estimates of retirement costs could change as a result of changes in cost estimates and regulatory requirements.

For certain of the Company's assets it is not possible to make a reasonable estimate of AROs due to the indeterminate timing and scope of the asset retirements.

Depreciation expense includes a provision for AROs at rates approved by the regulator. Actual costs incurred are charged to accumulated depreciation in accordance with regulatory treatment.

(k) Pension and other post-employment benefits:

The Corporation accounts for its participation in OMERS, a multi-employer public sector pension fund, as a defined contribution plan. The Corporation obtained approval from the OEB to defer pension expenses incurred from January 1, 2005 to April 30, 2006.

1.Significant accounting policies (continued):

The Corporation actuarially determines the cost of other employment and post-employment benefits offered to employees using the projected benefit method, prorated on service and based on management's best estimate assumptions. Under this method, the projected post-retirement benefit is deemed to be earned on a pro rata basis over the years of service in the attribution period commencing at date of hire, and ending at the earliest age the employee could retire and qualify for benefits.

(l) Regulatory assets and liabilities:

Regulatory assets primarily represent costs that have been deferred because they are expected to be recovered in future rates. Similarly, regulatory liabilities can arise from differences in amounts billed to customers under the regulated pricing mechanism and the corresponding wholesale market cost of power incurred by the utility.

Regulatory balances are comprised principally as follows:

(i) Deferred OMERS and OEB assessed cost represents pension and OEB assessed expenses deferred from January 1, 2005 to April 30, 2006 and from January 1, 2004 to April 30, 2006, respectively.

(ii) Retail settlement variances - are variances that have occurred since May 1, 2002, when the competitive electricity market was declared open and that have accumulated pursuant to direction from the OEB. Specifically, these amounts include variances between the amounts charged by the Independent Electricity System Operator ("IESO") for the operation of the markets and grid, as well as various wholesale market settlement charges and transmission charges as compared to the amount billed to consumers based on the OEB-approved rates.

(iii) All revenue and associated costs for the smart meter program have been deferred as directed by the OEB in their April 12, 2006 rate decision.

In November 2003, the Province of Ontario introduced the 2003 Act, which implemented a new electricity pricing regime believed to better reflect the true cost of electricity.

**1. Significant accounting policies (continued):**

The 2003 Act, which received Royal Assent in December 2003, removed the $0.043/kWh electricity price freeze established under the Electricity Pricing, Conservation and Supply Act, 2002 and gave the OEB the power to establish the electricity commodity price for low volume consumers and designated consumers who do not choose an electricity retailer.

The OEB can adjust the electricity commodity prices charged to these consumers every six months as required.

The interim pricing for the first 750 kWh consumed in any month by any regulated price plan ("RPP") customers from the January 1, 2010 through April 30, 2010 period was $0.050/kWh, and $0.058/kWh for consumption in excess of that amount. Electricity prices increased effective May 1, 2010 to $0.058/kWh for the first 600 kWh consumed in a month and to $0.067/kWh for consumption in excess of that amount. The price threshold was also changed to 600 kWh per month for the period from May 1 through October 31 and 1,000 kWh per month during the period from November 1 through April 30. The threshold for non-residential eligible customers that were eligible under RPP remained unchanged at 750 kWh per month throughout the year.

On October 11, 2010, the OEB announced additional changes to interim electricity prices for RPP customers to take effect November 1, 2010 Electricity interim prices decreased effective November 1, 2010 from $0.058/kWh to $0.055/kWh for the first 1,000 kWh consumed in a month and from $0.067/kWh to $0.064/kWh for consumption in excess of that amount.

On April 12, 2011, the OEB announced further changes to interim electricity prices for RPP customers to take effect May 1, 2011. Electricity interim prices decreased effective May 1, 2011 from $0.055/kWh to $0.053/kWh for the first 600 kWh consumed in a month and from $0.064/kWh to $0.062/kWh for consumption in excess of that amount.

On October 12, 2011, the OEB announced additional changes to electricity prices for RPP customers which took effect November 1, 2011. Electricity decreased effective November 1, 2007 from $0.053/kWh to $0.050/kWh for the first 1,000 kWh consumed in a month and from $0.062/kWh to $0.059/kWh for consumption in excess of that amount. The threshold for non-residential customers that are eligible under RPP will remain at 750 kWh per month throughout the year.

**1. Significant accounting policies (continued):**

In August 2009, the Corporation submitted a rate application to the OEB for the rate period beginning May 1, 2010 and ending on April 30, 2011. This rate application proposed the full re-basing of the Corporation's electricity distribution rates to more accurately reflect the Corporation's current rate base and cost structure. On April 12, 2010, the OEB released its decision and order regarding the Corporation's rate application. This decision allowed for a distribution rate increase of approximately 2.3% on the total bill of an average residential customer using 1,000 kWh per month. The decision also allowed for a newly introduced rate increase for smart meters.

On June 12, 2010, the Corporation submitted a review and vary motion to the OEB to revise its approved 2010 tariff of rates and charges. On October 3, 2010, the OEB released its final decision regarding this motion. The decision allowed for additional expense recoveries of $1,200 annually and a $3,000 adjustment to dispose of the liability balances recorded in the Corporation's retail settlement variance accounts, as of December 31, 2009, over a two-year period.

In January, 2011, the Corporation submitted a formula based rate application to the OEB for the rate period May 1, 2011 through April 30, 2012. On April 12, 2011, the OEB released its decision and order on this rate application. This decision, along with the OEB announced changes to electricity prices effective May 1, 2011, increased the total bill of an average residential customer consuming 1,000 kWh of electricity per month by approximately 1.4%.

(m) Foreign currency translation:

Monetary assets and liabilities denominated in foreign currencies are translated at the prevailing rates of exchange at the balance sheet date. Revenue and expenses are translated at the exchange rates prevailing on the transaction date. Realized and unrealized exchange gains and losses are included in income.

(m) Taxation:

Income tax expense comprises current and future income taxes. Income tax expense is recognised in profit or loss except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Under the Electricity Act, 1998, the Corporation is required to make Payments In Lieu of Taxes (“PILs”) to Ontario Energy Financial Corporation ("OEFC"). These payments are calculated in accordance with the rules for computing income and taxable capital and other relevant amounts contained in the Income Tax Act (Canada) and the Corporations Tax Act (Ontario), as modified by the Electricity Act, 1998, and related regulations. PILs expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Future income taxes are recognised using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Future income taxes are measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Future tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

Future tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Future tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer more likely than not that the related tax benefit will be realized.

Management believes that when future income taxes become payable, or the assets are realized, the amounts will be included in rates approved by the OEB and recovered from customers at that time. For this reason, a regulatory liability or asset is recognized on these future income tax assets or liabilities.

(In thousands of dollars)

**2. Payments in lieu of corporate income taxes and future taxes:**

**a) Income taxes expense:**

| | 2011 | 2010 |
|---|---|---|
| Profit before payments in lieu of corporate income taxes | $ 23,000 | $ 24,000 |
| Statutory Canadian federal and provincial income taxes rate | 36% | 36% |
| Tax charge at statutory income taxes rate | $ 8,280 | $ 8,640 |
| Amortization of regulatory asset for future taxes | 720 | 2,360 |
| Total charge for payments in lieu of corporate income taxes | $ 9,000 | $ 11,000 |

The tax charge at statutory income taxes rate comprises of:

| | 2011 | 2010 |
|---|---|---|
| Payments in lieu of corporate income taxes | $ 9,000 | $ 11,000 |
| Future income taxes | (720) | (2,360) |
| | $ 8,280 | $ 8,640 |

**b) Future income tax liabilities:**

| | 2011 | 2010 |
|---|---|---|
| Future income tax assets | | |
| Employee retirement and post-retirement benefits | $ (1,080) | $ (1,080) |
| Future income tax liabilities | | |
| Capital assets | 5,000 | 5,720 |
| Regulatory asset gross-up entry (note 4) | 2,206 | 2,611 |
| Balance, end of the year | $ 6,126 | $ 7,251 |

Future income tax liabilities reconciliation:

| | 2011 | 2010 |
|---|---|---|
| Balance at beginning of the year | $ 7,251 | $ 10,939 |
| Charge for the year | (720) | (2,360) |
| Adjustment for regulatory asset gross-up entry (note 4) | (405) | (1,328) |
| Balance, end of the year | $ 6,126 | $ 7,251 |

(In thousands of dollars)

**3. Capital assets:**

| | Cost | Accumulated amortization | 2011 Net book value | 2010 Net book value |
|---|---|---|---|---|
| Land | $ 4,000 | $ – | $ 4,000 | $ 4,000 |
| Land rights | 28,000 | 8,000 | 20,000 | 22,000 |
| Buildings | 15,000 | 5,000 | 10,000 | 10,000 |
| Distribution station equipment | 82,000 | 34,000 | 48,000 | 46,000 |
| Distribution system | 601,000 | 288,000 | 313,000 | 300,000 |
| Equipment and furniture | 28,000 | 15,000 | 13,000 | 12,000 |
| Computer software | 4,000 | 2,000 | 2,000 | 2,000 |
| Construction in progress: | | | | |
| Equipment and furniture | 3,000 | – | 3,000 | - |
| Electric distribution system | 6,000 | – | 6,000 | 8,000 |
| | $ 771,000 | $ 352,000 | $ 419,000 | $ 404,000 |

During the year, $400 (2010 - $400), representing an allowance for the cost of funds used during construction, was capitalized to construction in progress.

(In thousands of dollars)

## 4. Regulatory assets and liabilities:

Regulatory assets and liabilities can arise as a result of the rate-making process. The following table demonstrates the impact on 2011 earnings net of PILs as a result of regulated accounting requirements.

| | 2011 | 2010 | Estimated remaining settlement period (years) | 2011 impact on net income ((a)(i)) |
|---|---|---|---|---|
| Regulatory assets: | | | | |
| Deferred OMERS employer contributions ((a)(ii)) | $ 2,000 | $ 2,000 | 1 - 2 | $ (500) |
| Other regulatory assets ((a)(iii)) | 1,000 | 1,000 | 1 - 2 | 500 |
| | 3,000 | 3,000 | | - |
| Regulatory assets approved for recovery ((a)(v)) | 4,000 | 14,000 | 2 - 3 | 1,280 |
| | 7,000 | 17,000 | | 1,280 |
| Other regulatory assets | | | | |
| Future income taxes recoverable through future rates ((a)(vi)) | 3,920 | 4,640 | 3 - 4 | 720 |
| Future taxes regulatory asset gross-up entry ((a)(vi)) | 2,206 | 2,611 | 3 – 4 | - |
| | 6,126 | 7,251 | | 720 |
| Total regulatory assets | $ 13,126 | $ 24,251 | | $ 2,000 |
| Regulatory liabilities: | | | | |
| Smart meter revenue/expense ((a)(iv)) | (3,000) | (2,000) | 3 - 4 | (640) |
| Retail settlement variances ((a)(v)) | $ (21,000) | $ (8,000) | 1 - 2 | (8,320) |
| | $ (24,000) | $ (10,000) | | $ (8,960) |

**4. Regulatory assets and liabilities (continued):**

(a) Explanatory notes:

(i) The 2011 impact on earnings net of PILs represents the effect on net income as a result of the treatment under rate regulated accounting. The amounts are net of the amortization charge relating to regulatory assets/liabilities and PILs.

(ii) The OEB had approved the deferral of the Corporation's employer portion of pension contributions to OMERS retirement fund.

(iii) The OEB requires that the Corporation record and defer the difference between revenue and costs associated with providing retailers with customer settlement services as retail cost variance account deferrals and had approved the deferral of the Corporation's OEB assessed costs between January 1, 2004 and April 30, 2006. These items are included in other regulatory assets.

(iv) On June 13, 2006, the OEB issued an update to the accounting procedure handbook regarding the accounting treatment for smart meter expenditures. This amount reflects the net amount of revenue and expenses deferred since May 1, 2006.

(v) The OEB requires the Corporation to record and defer the difference between energy charged to its customers and the actual cost of power incurred and paid to the IESO and to Hydro One. The retail settlement variance reflects this difference since January 1, 2005 plus interest charged at an OEB approved rate.

(vi) The regulatory liability/asset for future taxes represents the amount of future income taxes which, when payable or the assets are realized, management expects to be included in the rates approved by the OEB. These amounts will therefore be recovered from or refunded to customers at that time. The gross-up entry is to increase the amount that is expected to be recovered or paid on these future taxes to a pre-tax amount.

The Corporation accrues interest on the deferral account balances for the regulatory assets and retail settlement variances, as directed by the OEB. As at December 31, 2011, this net accrued interest amounted to $200 (2010 - $400).

**4. Regulatory assets and liabilities (continued):**

(b) Financial statement effects of rate regulation:

(i) General information regarding rate regulation and its economic effects:

The operations of the Corporation are regulated by the OEB. The OEB exercises statutory authority over matters such as construction, rates and underlying accounting practices, and rate setting issues with the Corporation's customers.

On April 12, 2010, the Corporation's rate application was approved by the OEB for the rate period beginning May 1, 2010 and ending on April 30, 2011. These rates are set by the OEB under a cost of service methodology that allows revenue to recover utility operating costs plus a regulated rate of return on the equity financed portion of the Corporation's rate base. The allowed rate of return for this rate period is set by the OEB at 9.0%.

In January, 2011, the Corporation submitted a formula based rate application to the OEB for the rate period May 1, 2011 through April 30, 2012.

(ii) Regulatory risk and uncertainties affecting recovery or settlement:

The regulatory assets and liabilities recorded in the financial statements are based upon an expectation of the future actions of the OEB. To the extent that the OEB's future actions are different from the Corporation's expectations, the timing and amount of recovery or settlement of amounts recorded on the balance sheet could be significantly different from the timing and amounts that are eventually recovered or settled.

(iii) Financial statement effects:

In order to recognize the economic effects of the actions or expected actions of the regulator, the timing of recognition of certain revenue and expenses in these operations may differ from that otherwise expected under GAAP for non rate-regulated entities.

(In thousands of dollars)

**4. Regulatory assets and liabilities (continued):**

Regulatory assets represent amounts that are expected to be recovered from customers in future periods through the rate setting process. In the absence of rate regulated accounting, GAAP would not permit deferral of regulatory assets and, therefore, the earnings impact would be recorded in the period of recovery. Regulatory assets are recorded in other assets in the balance sheet.

Regulatory liabilities represent amounts that are expected to be refunded to customers as a result of the rate-setting process. The GAAP treatment of regulatory liabilities and the resulting earnings impact is the same as that under rate-regulated accounting because the liabilities represent contractual obligations. Regulatory assets and liabilities are recorded as non-current amounts in the balance sheet.

(c) Other items affected by rate regulation:

Future income taxes:

The Corporation recovers tax expense based on the taxes payable method as prescribed by the OEB. As such, the rates approved by the OEB do not include the recovery of future income taxes related to temporary differences. The Corporation records future income tax assets or liabilities arising from its business activities. However, to the extent that it is expected that the recovery/realization or payment of these amounts will be included in future distribution rates, a regulatory liability or asset is recognized on these future income tax assets or liabilities. In the absence of rate-regulation, the regulatory liability/asset would not be recognized.

**5. Bonds payable:**

| | 2011 | 2010 |
|---|---|---|
| 6.29% Series Bonds,<br>Tranche 1, due May 3, 2015 | $ 290,000 | $ 290,000 |
| Deferred debt issue costs (net of accumulated<br>amortization of $3,000 (2010 - $2,000)) | (1,000) | (2,000) |
| Net bonds payable | $ 289,000 | $ 288,000 |

Interest expense includes $18,000 (2010 - $18,000) in respect of interest on long-term liabilities and amortization of debt issue costs in the amount of $1,000 (2010 - $1,000).

(In thousands of dollars)

## 6. Capital stock:

(a) Background:

The City Council approved a by-law, effective January 1, 2000, affecting the transfer of the electricity distribution business formerly conducted by the Hydro Utility to the Corporation. The City received consideration in the form of a note receivable for $150,000 and common shares in exchange, at the time of the transfer. On December 6, 2001, the City received further consideration in the form of a note receivable for $119,214 and a dividend of $20,785 when it exchanged shares issued on January 1, 2000 for shares of the Corporation. The transfers were recorded at net book value.

(b) Capital stock:

| | 2011 | 2010 |
|---|---|---|
| Authorized: | | |
| Unlimited common shares | | |
| Issued: | | |
| 40 common shares | $ 156,000 | $ 156,000 |

In 2011, the Corporation declared and paid a dividend to its shareholder in the amount of $7,500 (2010 - $9,000).

## 7. Change in non-cash operating working capital:

| | 2011 | 2010 |
|---|---|---|
| Accounts receivable | $ 3,000 | $ (7,000) |
| Unbilled revenue | (8,000) | 13,000 |
| Amounts due to/from related parties | - | (1,000) |
| Inventories | (2,000) | (1,000) |
| Prepaid expenses and deposits | - | 1,000 |
| Accounts payable and accrued liabilities | (7,000) | (38,000) |
| Payments in lieu of corporate income taxes payable | (1,000) | (2,000) |
| Advance payments | - | 1,000 |
| | $ (15,000) | $ (34,000) |

(In thousands of dollars)

## 8. Employee retirement and post-retirement benefits:

(a) Pensions:

During fiscal 2011, the Corporation made contributions of $1,675 (2010 - $1,585). With the OEB's approval, the Corporation has deferred nil (2010 - $331) of its pension expense for recovery in future rates.

(b) Other retirement and post-retirement benefits:

The Corporation presently offers two separate retirement and post-retirement benefit plans. The amounts presented are based upon an actuarial valuation performed as of December 31, 2010 on March 2, 2011. The next valuation is expected to be performed for the year ending December 31, 2013.

Reconciliation of accrued benefit obligation to balance sheet liability:

| | 2011 | 2010 |
|---|---|---|
| Retirement and post-retirement life benefits | $ 2,400 | $ 2,700 |
| Retirement and post-retirement health and dental benefits | 600 | 300 |
| Accrued benefit obligation | $ 3,000 | $ 3,000 |

(c) Retirement and post-retirement life benefits:

(i) Post-employment benefits liability:

| | 2011 | 2010 |
|---|---|---|
| Benefit obligation, beginning of year | $ 2,400 | $ 2,600 |
| Service cost | 100 | 100 |
| Interest cost | 100 | 200 |
| Benefits paid | (100) | (100) |
| Unrecognized actuarial loss | – | 200 |
| Post-employment benefits liability, end of year | $ 2,500 | $ 3,000 |

(In thousands of dollars)

## 8. Employee retirement and post-retirement benefits (continued):

(ii) Reconciliation of accrued benefit obligation to balance sheet liability:

| | 2011 | 2010 |
|---|---|---|
| Accrued benefit obligation, end of year | $ 2,500 | $ 3,000 |
| Unrecognized actuarial loss | (100) | (300) |
| Accrued benefit obligation | $ 2,400 | $ 2,700 |

(iii) Significant assumptions:

| | 2011 | 2010 |
|---|---|---|
| Discount rate | 5.25% | 5.25% |
| Rate of compensation increase | 2.50% | 2.50% |

The principal funding obligation of the plan is to fund life insurance benefits based on employment date and years of service. A limited group of former employees who elected to retire under a special early retirement incentive plan is entitled to continuation of health and dental premiums at their own expense, until age 65. Accordingly, based on the current participation profile, changes in health and dental care costs will not significantly impact the estimates of the plan obligations. Net actuarial gains or losses over 10% of the accrued benefit obligation, are amortized into expense on a straight-line basis over the expected average remaining service lifetime. There are no transition obligations to be amortized from past services.

A 1% increase (decrease) in the interest assumption would decrease (increase) the post-retirement benefit obligation and the service cost by approximately 14% to 16%.

The Corporation's net life insurance benefit expense is as follows:

| | 2011 | 2010 |
|---|---|---|
| Current service cost | $ 100 | $ 100 |
| Interest cost | 100 | 200 |
| | $ 200 | $ 300 |

(In thousands of dollars)

**8. Employee retirement and post-retirement benefits (continued):**

(d) Retirement and post-retirement health and dental benefits:

(i) Post-employment benefits liability:

| | 2011 | 2010 |
|---|---|---|
| Change in benefit obligations: | | |
| Benefit obligation, beginning of year | $ 1,450 | $ – |
| Service cost | 100 | 100 |
| Amortization of transition obligation | 150 | 150 |
| Interest cost | 100 | 50 |
| Transition obligation | (50) | 1,000 |
| Actuarial losses | – | 150 |
| Post-employment benefits liability, end of year | $ 1,750 | $ 1,450 |

(ii) Reconciliation of accrued benefit obligation to balance sheet liability:

| | 2011 | 2010 |
|---|---|---|
| Benefit obligation, end of year | $ 1,750 | $ 1,450 |
| Unrecognized transition obligation | (900) | (1,000) |
| Unrecognized actuarial loss | (250) | (150) |
| Accrued benefit obligation | $ 600 | $ 300 |

(iii) Significant assumptions:

| | 2011 | 2010 |
|---|---|---|
| Discount rate | 5.25% | 5.25% |
| Expected return on plan assets | 5.25% | 5.25% |
| Health care cost increases | 14.00% | 15.00% |
| Dental cost increases | 5.00% | 5.00% |

(In thousands of dollars)

### 8. Employee retirement and post-retirement benefits (continued):

The Corporation's net health and dental benefit expense is as follows:

| | 2011 | 2010 |
|---|---|---|
| Amortization of transition obligation | $ 150 | $ 150 |
| Current service cost | 100 | 100 |
| Interest cost | 100 | 50 |
| | $ 350 | $ 300 |

The principal funding obligation of the plan is to fund health and dental benefits to those employees who retire on or after age 55 with at least 10 years of service with a specified cost sharing formula for participation from the time of early retirement to age 65. Net actuarial gains or losses over 10% of the accrued benefit obligation, are amortized into expense on a straight-line basis over the expected average remaining service lifetime. The unrecognized transition obligation will be amortized over the expected average remaining service lifetime.

The December 31, 2010 actuarial valuation assumed health care costs would increase by 14% in 2010, then grading down to 4% per annum after 10 years. Dental costs were assumed to increase by 5% in 2010, then grading down to 3% per annum after 10 years.

A 1% increase (decrease) in the interest assumption would decrease (increase) the expected post-retirement benefit obligation, the interest cost and the service cost by approximately 10%.

## 9. Contingencies:

(a) Insurance claims:

The Corporation is a member of the Municipal Electric Association Reciprocal Insurance Exchange ("MEARIE"). A reciprocal insurance exchange may be defined as a group of persons formed for the purpose of exchanging reciprocal contracts of indemnity or inter-insurance with each other. MEARIE is licensed to provide general liability insurance to its members.

Insurance premiums charged to each member consist of a levy per thousand dollars of service revenue subject to a credit or surcharge based on each member's claims experience. Current coverage is provided to a level of $30,000 per incident.

The Corporation has been jointly named as a defendant in several actions. No provision has been made for these potential liabilities as the Corporation expects that these claims are adequately covered by its insurance.

(b) Other claims:

A class action claiming $500,000 in restitutionary payments plus interest was served on Toronto Hydro on November 18, 1998. The action was initiated against the former Toronto Hydro-Electric Commission as the representative of the Defendant Class, consisting of all municipal electric utilities in Ontario which have charged late payment charges on overdue utility bills at any time after April 1, 1981.

The claim is that late payment penalties result in the municipal electric utilities receiving interest at effective rates in excess of 60% per year, which is illegal under Section 347(1)(b) of the Criminal Code. The Electricity Distributors Association is undertaking the defence of this class action.

On April 22, 2004, the Supreme Court of Canada released its decision in a case commenced against Enbridge Gas Distribution ("EGD") with respect to late payment penalties. At the end of 2010, a mediation process resulted in the settlement of the damages payable by EGD. After the release by the Supreme Court of Canada of its 2004 decision in the EGD case, the plaintiffs in the electric utilities late payment class action indicated their intention to proceed with their litigation. To date, no formal steps have been taken to move the action forward.

**9. Contingencies (continued):**

On February 5, 2008, the OEB made a decision to allow EGD to recover $22,000 from ratepayers following the settlement of the class-action lawsuit related to late payment penalties.

At this time, it is not possible to quantify the effect, if any, on the financial statements of the Corporation as a result of the Toronto Hydro-Electric Commission class action. It is the Corporation's position that any late payment charges that are required to be repaid to customers as a result of this class action would be included in a rate adjustment based on the February 5, 2008 EGD decision.

(c) Environmental matters:

As part of the Corporation's ongoing risk mitigation strategy, environmental assessments of Corporation properties are underway. At December 31, 2011, the Corporation accrued $400 for future soil remediation at three sites. At this time, it is not possible to further quantify the final outcomes at these properties or others not yet assessed.

**10. Commitments:**

(a) Guarantees:

Purchasers of electricity in Ontario, through the IESO, are required to provide security to mitigate the risk of their default on their expected activity in the market. The IESO could draw on this security if the Corporation failed to make payment required by a default notice issued by the IESO. The Corporation has posted a letter of credit as security in the amount of $9,000 (2010 - $17,000).

(b) Commitments:

The Corporation leases equipment under operating lease agreements. The minimum lease payment due in 2011 under these agreements is nil (2010 - $2,000).

(In thousands of dollars)

## 11. Financial instruments:

The carrying values of cash and cash equivalents, accounts receivable, cash and cash equivalents held for consumer deposits, accounts payable and accrued liabilities, advance payments and amounts due to and from related parties approximate fair values because of the short maturity of these instruments.

The bonds payable, having a carrying value of $289,000 (2010 - $288,000), have a fair value of $305,000 (2010 - $311,000) based on year-end quoted market prices.

Financial assets held by the Corporation expose it to credit risk. As at December 31, 2011 and 2010, there were no significant concentrations of credit risk with respect to any class of financial assets. The Corporation earns its revenue from a broad base of customers located principally in the City. No single customer would account for revenue or an accounts receivable balance in excess of 10% of the respective reported balances.

## 12. Related party transactions:

The Corporation provides electricity and services to the principal shareholder of its parent company, the City. Electricity is billed to the City at the prices and terms as approved by the OEB. Other construction services are provided at cost. A summary of amounts charged by the Corporation to the City is as follows:

| | 2011 | 2010 |
|---|---|---|
| Electrical energy | $ 8,000 | $ 7,000 |
| Street lighting energy | 4,000 | 3,000 |

The Corporation charged the City $100 for other construction services in 2011 (2010 - $500).

The Corporation charged a related corporation $10 (2010 - $7) for an access agreement and was recorded at the exchange amount being the amount agreed to by the parties. At December 31, 2011, accounts receivable included $1 (2010 - $1) due from BPC.

During 2011, the Corporation was charged $10,000 (2010 - $8,000) by a company under common ownership, for construction of distribution infrastructure.

**12. Related party transactions (continued):**

At December 31, 2011, accounts payable and accrued liabilities include $40 (2010 - $60) due to the City and accounts receivable includes $1,800 (2010 - $1,900) due from the City.

Amounts due from related parties include $nil (2010 - $1,000) from a company under common control and nil (2010 - nil) from the parent company.

Amounts due to related parties include $300 (2010 - $1,000) to a company under common control and $700 (2010 - $1,000) to the parent company.

**13. Energy purchases:**

As a participant in the competitive electricity market, all electricity purchases for standard supply customers are subject to pricing determined by the IESO, a provincial government body.

Included in accounts payable and accrued liabilities as at December 31, 2011 is $47,000 (2010 - $50,000) owed in respect of electricity purchases through the IESO.

**14. Comparative figures:**

Certain comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.